INTER-CITY GAS LIMITED

ANNUAL REPORT
1979

File

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Annual Report on Form 10K

The SEC Annual Report Form 10K for the year ended December 31, 1979 for Inter-City Gas Limited or Canadian Homestead Oils Limited will be provided by mail upon receipt of a written request. Such written requests should be directed to: the Secretary, Inter-City Gas Limited, Inter-City Gas Building, 444 St. Mary Avenue, Winnipeg, Manitoba R3C 3T7.

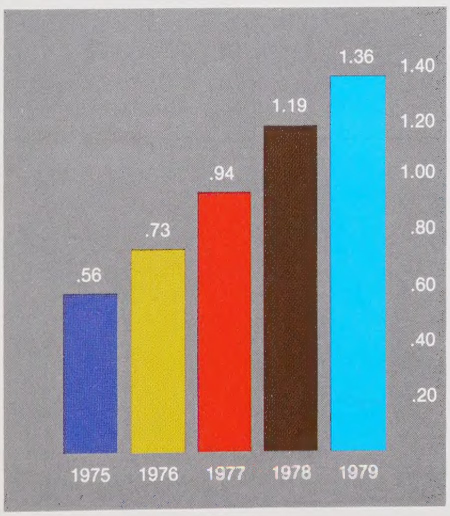
INTER-CITY GAS LIMITED

HIGHLIGHTS

	1979	1978	Change
FINANCIAL	($000)	($000)	%
Gross revenues	**454,383**	390,066	16.5
Operating profit	**41,504**	31,935	30.0
Net income per common share			
–before extraordinary items	**$1.36**	$1.19	14.3
–after extraordinary items	**$1.43**	$1.21	18.2
Cash dividends per common share	**$0.31**	$0.28	10.7
Long-term debt	**93,539**	100,217	(6.6)
Shareholders' equity	**73,678**	61,454	19.9
Total assets	**364,623**	333,064	9.5
Capital expenditures	**31,658**	29,462	7.5
Average number of common shares outstanding (thousands)	**7,571**	4,944	53.1
OPERATING	**1979**	1978	%
Propane–gallons	**213,660,000**	200,411,000	6.6
Gasoline and other petroleum products–gallons	**159,655,000**	185,838,000	(14.1)
Natural gas–			
–Utility sales–Mcf	**47,218,100**	45,387,000	4.2
–Production sales–Mcf after royalties	**7,494,500**	7,477,000	0.2
Oil production–			
–Barrels after royalties	**240,500**	256,763	(6.3)
Net proved reserves (after royalties)			
Natural gas–thousand cubic feet			
Directly owned	**106,399,000**	116,967,000	
Canadian Homestead	**685,013,000***	740,917,000*	
Combined	**791,412,000**	857,884,000	
Oil–barrels			
Directly owned	**2,061,000**	3,000	
Canadian Homestead	**7,768,000**	7,896,000	
Combined	**9,829,000**	7,899,000	

*Includes reserves attributable to the Arctic Islands.

EARNINGS PER SHARE



Securities of the Company are traded on the American, Toronto and Winnipeg stock exchanges. The following table provides certain market information for the years ended December 31, 1979 and 1978.

Market price per common share (Toronto Exchange)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1979 High	$9.75	$16.00	$19.58	$22.50
Low	$8.125	$ 9.00	$14.50	$16.38
1978 High	$8.00	$ 7.375	$ 8.75	$ 8.875
Low	$6.375	$ 6.75	$ 6.75	$ 7.125
Dividends per common share				
1979	$0.07	$ 0.08	$ 0.08	$ 0.08
1978	$0.07	$ 0.07	$ 0.07	$ 0.07

DIRECTORS

ROBERT G. GRAHAM

WAYNE R. HARDING

GORDON P. OSLER

J. DEREK RILEY

GEORGE C. SOLOMON

ALAN SWEATMAN, Q.C.

MICHAEL J. WALTON

STOCK EXCHANGE LISTINGS

TORONTO STOCK EXCHANGE
AMERICAN STOCK EXCHANGE
WINNIPEG STOCK EXCHANGE

SOLICITORS

THOMPSON, DORFMAN,
SWEATMAN

AUDITORS

COOPERS & LYBRAND

TRANSFER AGENTS AND REGISTRAR

GUARANTY TRUST COMPANY
Winnipeg, Toronto
Calgary and Vancouver

HEAD OFFICE

Inter-City Gas Building
444 St. Mary Avenue
Winnipeg, Manitoba
R3C 3T7

OFFICERS

ROBERT G. GRAHAM
President and
Chief Executive Officer

WAYNE R. HARDING, C.A.
Executive Vice-President

C. ROY BEENHAM
Senior Vice-President
Administration and
Manufactured Products

N. J. DIDUR
Group Vice-President
Utilities

W. R. LOREN
Group Vice-President
Propane and Petroleum Products

PETER MARRIOTT, C.A.
Senior Vice-President
and Controller

RAY L. ZELL
Vice-President
(Exploration)

J. E. CARSTAIRS
Vice-President and
Secretary

BARRE W. HALL
Assistant Secretary

Left to right:
J. E. Carstairs   C. Roy Beenham   Peter Marriott   W. R. Loren   N. J. Didur   Wayne R. Harding

REPORT TO SHAREHOLDERS

Robert G. Graham

We are pleased to report that in 1979 net income to common shareholders, before extraordinary items, increased to $11,939,000 or $1.36 per share compared with $7,188,000 or $1.19 per share in 1978.
In 1979, there were 7,570,735 average shares outstanding compared with 4,943,713 in 1978. This increase reflects the completion during the year of the acquisition of 100% of Canadian Hydrocarbons Limited shares in exchange for shares of Inter-City Gas Limited.

Results for the two years can be compared more readily if it is assumed that 100% of the common shares of Canadian Hydrocarbons Limited were owned for the full 12 months in both years. On this basis, the net income to common shareholders, before extraordinary items, would have been $1.37 per share compared with $1.10 per share in 1978, an increase of 25%.

Our operating revenues rose to $454,383,000 from $390,066,000 in 1978, while operating profits including our share of Canadian Homestead Oils Limited earnings, rose to $41,504,000 from $31,935,000.

Dividends on common shares were increased during the year from 7 cents per quarter to 8 cents per quarter.

Capital expenditures in 1979 amounted to $31,658,000. Major items included customer installations and services in our Utilities and Propane Divisions, and exploration and development expenditures for oil and natural gas. Funds required for capital expenditures were provided from operations, bank credit lines, and from the placement of $5,500,000 in a long-term debenture and a mortgage both at an 11% fixed interest rate. In addition, Canadian Homestead's capital expenditures amounted to $21,642,000 of which $5,077,000 was incurred on the South Rosevear gas plant.

1979 was a significant year for your Company in a number of other ways. In May, 1979 we announced that we were proceeding to develop a plan of amalgamation with Canadian Homestead Oils Limited on the basis of 1.4 common shares of the amalgamated company for each common share of Canadian Homestead and one common share of the amalgamated company for each common share of Inter-City. The successful conclusion to this plan was achieved on March 28, 1980, when shareholders of both companies agreed to an amalgamation of their companies on the above basis. The amalgamation became effective on April 14, 1980. We believe that the amalgamated company, Inter-City Gas Corporation, will have a more balanced financial and operational configuration than either of the separate entities and that the potential for growth and capital appreciation will be enhanced.

Since the timing of the amalgamation coincided with the publication of our Annual Report, we believe shareholders of the amalgamated corporation would appreciate receiving a comprehensive report covering both companies. Thus the financial statements for both Inter-City and Canadian Homestead are included in this report together with other financial and operational information on both companies.

In February, 1980 we announced that we had entered into an agreement to sell our two small oil refineries, gas plant and related petroleum assets located in the mid-western United States. While these operations contributed substantially to revenues, they produced only $1,701,000 of operating profits in 1979. Further discussion of this sale is contained later in this report.

The general outlook for 1980 is promising, although inflation and high interest rates will continue to have an impact on our operating results. The outlook for your Company and the energy industry as a whole will be influenced by the nature of agreements reached by the Federal Government and the oil-producing provinces relating to oil and gas pricing, and by the decision on the proposed natural gas pipeline east of Montreal.

In 1979, we welcomed to the Board of Directors, Mr.

George C. Solomon and Mr. Michael J. Walton, who were formerly directors of Canadian Hydrocarbons Limited. The initial board of Inter-City Gas Corporation will consist of seven directors, all of whom are the present directors of Inter-City Gas Limited.

Mr. Wayne R. Harding, who has been Executive Vice-President of your Company since 1970 is now Vice-President Corporate Development. He is now resident in the United States and will be pursuing our developments there.

The remainder of this report reviews the results and operations of our divisions: Exploration and Production. Propane and Petroleum Products, Utilities and Manufactured Products.

On behalf of the Board

R. G. GRAHAM
President and Chief Executive Officer

EXPLORATION AND PRODUCTION DIVISION

HIGHLIGHTS	Direct Operations			Canadian Homestead		
	1979	1978	Change	**1979**	1978	Change
	($000)	($000)	%	($000)	($000)	%
Operating revenues	**15,560**	13,912	11.8	**11,541**	8,549	35.0
Operating profit	**9,303**	7,770	19.7	**6,008**	4,475	34.2
Capital expenditures	**7,364**	6,354	17.0	**21,642**	11,283	91.8
Assets employed	**48,207**	41,560	16.0	**63,193**	48,725	29.7
Average net daily production						
Natural gas (Mcf)	**20,533**	20,485	0.2	**7,211**	5,300	36.1
Oil (barrels)	**659**	703	6.2	**1,323**	1,326	(0.2)
Proved reserves net of royalties at year-end						
Natural gas (Mcf)	**106,399,000**	116,967,000		**685,013,000***	740,917,000*	
Oil (barrels)	**2,061,000**	3,000		**7,768,000**	7,896,000	

*Including reserves attributable to the Arctic Islands.

Direct Operations
Inter-City participates in exploration and drilling for gas and oil in both Canada and the United States. We hold working and royalty interests in producing oil and gas wells primarily located in Alberta, British Columbia, North Dakota, Montana, Texas and Louisiana. The sale of our Petroleum Products Division assets in North Dakota and Montana included our exploration interests in these states. Concurrently with the sale however, the Company entered into a farmin agreement with the purchasers so that we remain active in exploration of the undeveloped acreage included in the sale.

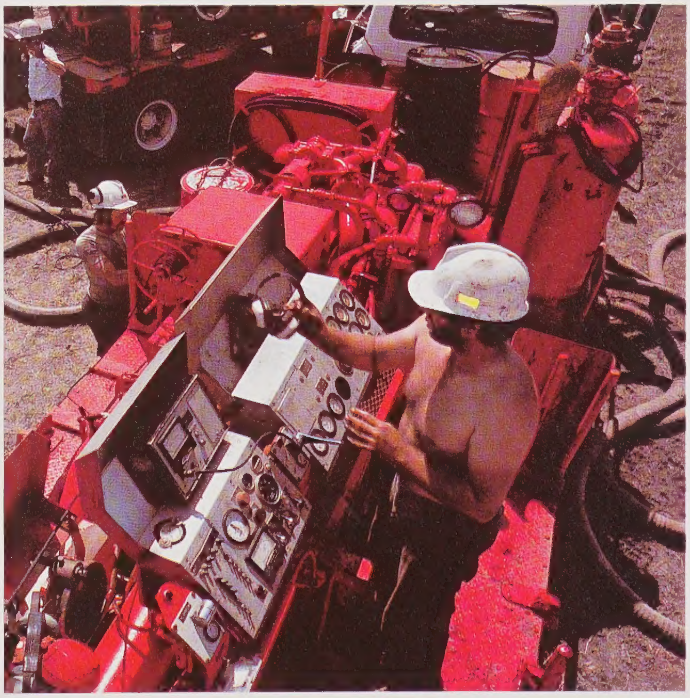
Our activity during the year included exploration and development drilling extending from the Fort St. John area of British Columbia across the breadth of the Western Canada sedimentary basin to the Medicine Hat area of southern Alberta. These exploration ventures ranged from deep prospects in the Alberta Foothills, through moderate depth stratigraphic prospects in the Sundre and Sylvan Lake areas, to shallow gas exploration and production in the Lac La Biche and Medicine Hat areas. In the United States, Inter-City participated in exploratory and development drilling in North Dakota and Montana. Net expenditures increased to $7,364,000 from $6,354,000 in 1978.

Some areas where the Company is currently active are as follows:

Wander, Avenir and Mills–
Inter-City participated in eleven wells of which nine were completed as gas wells. The Company earned a 25% interest in 15,000 acres and additional drilling is planned for 1980.

Foothills–
On the Coalbranch and Lovett River prospects west of Hinton we are drilling with Gulf, Mobil and other partners to develop reserves which will be produced into Gulf's Hanlon gas plant which is now in the planning stage.

Southern Alberta–
Further development drilling has been done at Tweedie, Hilda, Many Islands, Medicine Hat South and Hotchkiss. Wells were also drilled by Inter-City for the Shelter drilling fund at Ardley, Benalto, Calling River and Dryden.



EXPLORATION AND PRODUCTION DIVISION (continued)

In total Inter-City participated in fifty-three exploratory and development wells compared to fifty-eight in 1978. Their status at year-end was as follows:

	1979	1978
Completed gas wells	**37**	39
Completed oil wells	**3**	2
Dry and abandoned	**11**	14
Drilling in progress	**2**	3
	53	58
Success rate	**78%**	75%
Wells operated by Inter-City	**38**	27

Although average daily production showed a marginal decrease over 1978, revenues increased by 11.8% due to various price adjustments during the year. The increase in revenues was reflected entirely in operating profits.

The principal purchasers of natural gas produced from exploration areas in Alberta are the natural gas transmission companies. In 1979 your Company produced gas sold only under contract to TransCanada PipeLines Limited, Pan-Alberta Gas Ltd. and Westcoast Transmission Limited.

At December 31, 1979, our proved reserves net of royalty interests were 106,399 million cubic feet of natural gas and 2,061 thousand barrels of crude oil.

Exploration activities have been given the highest priority in your Company's development, and we continue to devote much of our corporate effort towards the further development of these activities.

Canadian Homestead
The Company's drilling activities are concentrated in Western Canada, primarily in the province of Alberta. However, there is increasing activity in north-eastern British Columbia. Some areas of current interest are as follows:

Alberta–

GOLD CREEK–SADDLE HILLS
Interests varying from 5% to 15% are held in 150,000 acres in the Gold Creek region. To date, seven wells have been drilled, five of which are potential gas wells and two are oil wells with development drilling planned for 1980. The Company's interests at Saddle Hills covers 11,000 acres. Six gas wells have been completed in the Triassic Halfway Zone.

NORTH LISBURN
The Company has a 6½% interest in an oil well and gas well on lands which are pooled for purposes of drilling. Interests ranging from 25% to 100% are held in offsetting acreage. Additional drilling is planned for 1980.

LIEGE
Exploration in this region, where interests varying from 33⅓% to 66⅔% are held in 80,000 acres, indicates the probable presence of a substantial gas field. Two potential gas wells in which the Company has a 33⅓% interest have been drilled.

HEART LAKE
In the Heart Lake region of east-central Alberta, Canadian Homestead and partners entered into a seismic option and drilling arrangement whereby a 50% interest was earned in 22,720 acres. This resulted in three successful gas wells in which the Company has a 16⅓% interest. Further drilling is scheduled for the current year.

British Columbia–

GUNNELL
At Gunnell in north-eastern British Columbia, a previously abandoned test well was successfully re-entered and completed as a gas well. Two other wells were subsequently drilled resulting in one completed gas well. The other was abandoned. The Company holds interests ranging from 25% to 37½% in 16,000 acres.

UMBACH CREEK
The Company has participated in two gas wells with three more planned for 1980. We have a 15% interest in 13,000 acres in this area.

HASLER CREEK
The Company holds a 25% interest in a 38,000 acre permit in the Hasler Creek area of east-central British Columbia. In recent years an extensive seismic program has been conducted and as a result a prospective structure has been identified. A pooling arrangement has been made with an adjacent landholder and a Triassic test, in which we will have a 12½% interest, is scheduled to be drilled in the summer of 1980. The cost of this well will be approximately $5 million, an expenditure which is warranted by the potential for this acreage.

United States–

The Company participated in eleven wells during 1979 in the State of Texas. Five were completed as oil wells and one as a gas well. The Company has an approximate 21% interest in these wells which are

part of the Devonian oil play developing near the Tarzan North prospect from which the Company obtains most of its production. A favorable land position has been acquired in the area and it is expected that a substantial drilling program will be undertaken in 1980.

Net capital expenditures for land acquisition, exploration and development drilling and production facilities amounted to $21,642,000 in 1979 compared to $11,283,000 in 1978.

In total, Canadian Homestead participated in the drilling of sixty-five wells during 1979 compared with sixty-four in 1978. The results are as follows:

	1979	1978
Completed gas wells	**11**	8
Completed oil wells	**29**	24
Dry and abandoned	**25**	32
	65	64
Success rate	**61%**	50%

In addition, thirty-two wells were drilled by others on lands in which the Company has a royalty interest.

Average net daily crude oil production was relatively unchanged from 1978 at 1,323 barrels; average net daily natural gas production increased by 36.1% from 5.3 million cubic feet per day to 7.2 million cubic feet per day. Most of this increase was provided by the South Rosevear gas plant which commenced production effective November 1, 1979.

Net production revenues after deducting royalties increased by 35% due to increases in both prices and gas volumes as noted above. Net earnings for 1979 were $0.55 per common share compared with $0.50 per common share in 1978.

At December 31, 1979, Canadian Homestead's holdings of petroleum and natural gas leases, licenses, reservations and permits, totalled 12,736,400 gross acres (4,703,000 net acres). Proved reserves net of royalty interests were 7,768 thousand barrels of crude oil and 685,013 million cubic feet of natural gas (including 525,800 million cubic feet attributable to the Arctic Islands).

Details of the reserves of Inter-City and Canadian Homestead including the changes during the year are set out in the accompanying chart.

NET PROVED DEVELOPED AND UNDEVELOPED RESERVES	Inter-City		Canadian Homestead			Total	
	Oil and Condensate (Thousands of Barrels)	Natural Gas (Million Cubic Feet)	Oil and Condensate (Thousands of Barrels)	Natural Gas (Million Cubic Feet)		Oil and Condensate (Thousands of Barrels)	Natural Gas (Million Cubic Feet)
				Excluding Arctic Islands	Arctic Islands		
Proved reserves–January 1, 1979	3	116,967	7,896	153,037	587,880	7,899	857,884
Revisions to estimates	2,116	(8,748)	180	248	(62,080)	2,296	(70,380)
Production	(238)	(7,495)	(483)	(2,632)	–	(721)	(10,127)
Extension, discoveries and additions	180	5,675	175	8,560	–	355	14,235
Proved reserves–December 31, 1979	2,061	106,399	7,768	159,213	525,800	9,829	791,412


40 50 60
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70
20
80
10
90
5
95

PROPANE AND PETROLEUM PRODUCTS DIVISION

HIGHLIGHTS–Canada

	1979	1978	Change
	($000)	($000)	%
Operating revenues	**150,085**	144,039	4.2
Operating profit	**14,886**	10,692	39.2
Capital expenditures	**11,426**	7,675	48.9
Assets employed	**63,948**	58,051	10.1
	Thousands of Imperial Gallons		
Volumes			
Propane	**188,540**	176,163	7.0
Gasoline	**30,959**	45,558	(32.0)
Light and residual oils	**1,147**	1,087	5.5
	220,646	222,808	

HIGHLIGHTS–United States

	1979	1978	Change
	($000)	($000)	%
Operating revenues	**124,963**	92,058	35.7
Operating profit	**1,701**	913	86.3
Capital expenditures	**4,731**	7,031	(32.7)
Assets employed	**28,074**	28,226	(0.5)
	Thousands of Imperial Gallons		
Volumes			
Propane	**25,120**	24,248	3.6
Gasoline	**65,122**	74,105	(12.1)
Light and residual oils	**62,427**	65,090	(4.0)
	152,669	163,643	

The Company distributes propane and a variety of related merchandise, and gasoline throughout all regions of Canada except the Maritimes. The growth in propane volumes was primarily due to increased construction activity in Western Canada, and to higher export sales in Eastern Canada. The generally colder weather in 1979 had only a marginal effect on volume increases. We supplied close to 40% of the bulk propane used for both heating and industrial purposes across Canada. The Company also owns and operates a natural gas processing plant in Acheson, Alberta with a rated capacity of 10,000 Mcf per day. This plant produces propane, butane, and natural gas. In April, 1979 our retail gasoline stations in the Province of British Columbia were sold. These stations contributed 8.5 million gallons of gasoline in 1979 and 24.9 million gallons in 1978 to the Division's volumes. Excluding these volumes, the Company's gasoline sales through propane outlets increased by 1.8 million gallons or 8.8%.

Although reported operating revenues increased by only 4.2%, revenues after excluding the B.C. gasoline stations increased by $19,726,000 or 16.0%. This revenue increase was due to increased volumes, higher selling price for propane, plus increased merchandise sales through propane outlets. Improved margins on propane together with the increase in operating revenues resulted in operating profits improving by 39.2% to $14,886,000 for the year. Increased capital expenditures were for additional bulk tank cars and customer tank installations required to service the strong demand from oil field and construction customers.

In February, 1980 we entered into an agreement to sell the assets of our Petroleum Products Division in the United States. This included two small crude oil refineries in Montana and North Dakota, together with oil and gas properties in that area, and 106 retail outlets located across the north-western United States.

The net consideration for the sale is approximately $27,600,000 (U.S.) by way of cash and notes.

The U.S. Division was acquired as part of Canadian Hydrocarbons Limited and although it has produced significant revenues ($124,963,000 in 1979) it has never provided an adequate return on investment.

Additionally, in the early part of 1979 the small refiner's bias, which is so vital to the economical well-being of a small refinery, was cut in half and the promise of compensatory relief did not materialize. The cost of crude oil rose dramatically in 1979 particularly during the final quarter. Although we moved our gasoline prices to the allowable ceiling, heavy residual fuels which historically have followed the price of crude oil did not increase in price due to an over supply in the market. In December, 1979 we applied to the Department of Energy for temporary relief against the cost of crude oil, which by then was higher than the national average. This was denied and, although alternative solutions to the problem were considered, your Company felt that the sale of these operations provided the best overall action.

UTILITIES DIVISION

HIGHLIGHTS

	1979	1978	Change
	($000)	($000)	%
Operating revenues	**114,258**	98,903	15.5
Operating profit	**10,375**	10,052	3.2
Capital expenditures	**6,771**	7,290	(7.1)
Assets employed	**89,348**	85,617	4.4
Natural gas sales–Mcf	**47,218,100**	45,387,000	4.0

Your Company operates natural gas utilities systems in the provinces of British Columbia, Alberta, Manitoba, and Ontario in Canada, and in the state of Minnesota in the United States. At year-end, we served 83,584 customers in all our utilities, an increase of 5.4% from the previous year. The Utilities Division is also the distributor of electricity to the city of Yellowknife in the Northwest Territories.

The increase in the volume of gas sold was mainly due to an increase in the number of residential customers, temperatures which in 1979 averaged approximately 3.7 degrees colder than in 1978, and from slightly higher volumes to industrial customers. This improvement was achieved in spite of a decrease in volumes to certain industrial customers in the U.S. resulting from conservation measures and the higher Canadian export price of gas.

Operating revenues increased by 15.5% to $114,258,000 primarily as a result of the pass-through of increased costs of gas sold, and higher volumes.

Capital expenditures, which were slightly lower than in 1978, were incurred mainly for the extension of service to new customers.

During 1979, the Company was actively involved in the preparation of studies and at hearings in support of the extension of natural gas to unserved markets in Canada. In anticipation of a favorable decision from the National Energy Board, the Division is seeking the rights to distribute natural gas in these new market areas.

ICG Scotia Gas Limited has been formed in conjunction with local investors to serve the Province of Nova Scotia, and Gaz Inter-Cité Quebec Ltée is pursuing the distribution rights in the unserved areas of Quebec.

The Utilities Division operates in eight regulatory jurisdictions and processed a total of twenty rate adjustment applications during the year, of which fifteen were relative to the passing through of increased costs from our suppliers. Three were major hearings convened to examine our requests for increased revenues in order to offset increased operating costs, and two dealt with other rate-related matters. All these hearings resulted in satisfactory rate adjustments.

MANUFACTURED PRODUCTS DIVISION

HIGHLIGHTS–Canada

	1979	1978	Change
	($000)	($000)	%
Operating revenues	**28,471**	23,391	21.7
Operating profit	**1,280**	1,325	(3.4)
Capital expenditures	**156**	239	(34.7)
Assets employed	**12,389**	11,573	7.1

The Division operates plants in Winnipeg, Manitoba and St. Catharines, Ontario which manufacture residential and commercial heating equipment. Most of these products, together with related equipment manufactured by others such as residential air conditioning, ducts and fittings, water heaters, ventilating and humidification equipment, are sold to heating contractors through Company-owned distribution outlets in major Canadian cities in Western Canada, Ontario and Quebec. The remainder of the manufactured products are sold to wholesale distributors and, on a brand line basis, to retail chains. Shipments of manufactured products increased by 13.9% from 37,222 units in 1978 to 42,376 units in 1979 and these sales accounted for most of the increase in operating revenues.

The Division's Research and Development programs include the development of our own manufactured indirect fired heating/ventilating systems, a line of atmospheric and power gas conversion burners (in response to increasing demand for oil-to-natural-gas conversions), and the introduction of high-efficiency gas furnaces and burners.

HIGHLIGHTS–United States

	1979	1978	Change
	($000)	($000)	%
Operating revenues	**21,046**	17,463	20.5
Operating profit	**1,772**	(557)	418.3
Capital expenditures	**750**	691	8.5
Assets employed	**10,701**	11,184	(4.3)

The Company operates a plant in Denver, Colorado which manufactures both large diameter and corrugated steel pipe and distributes waterworks products of other manufacturers. The Division's products are used in water transmission, and in hydro electric and water and sewage treatment plants. Over 70% of the Division's sales are in large diameter steel pipe and related fabrication manufactured to customer specifications, and the backlog of orders for this product at December 31, 1979 amounted to $14,200,000 (U.S.).

The 20% increase in operating revenues to $21,046,000 was achieved through greater shipments in large diameter pipe. This increase in revenues, together with substantially improved product margins, contributed to an operating profit in 1979 compared with a loss in the previous year. The market for a large diameter steel pipe should continue to be strong with a number of pipeline projects expected to be available in 1980.


GUNNEL
BRITISH
COLUMBIA
INTER-CITY GAS
CANADIAN HOMESTEAD
EXPLORATION AND
PRODUCTION AREAS (CANADA)

INTER-CITY GAS LIMITED ACTIVITIES

PROPANE/PETROLEUM/MERCHANDISING
UTILITIES
MANUFACTURING/EQUIPMENT/MISCELLANEOUS
EXPLORATION/PRODUCTION

BUSINESS SEGMENTS

The following is an analysis of certain financial information by business lines and geographical areas. Information for the years 1975 to 1978 is prepared on a pro forma basis to include the results of Canadian Hydrocarbons Limited which became a 100% owned subsidiary in 1979.

		(in Thousands of Dollars)			Unaudited	
REVENUE		**1979**	1978	1977	1976	1975
Utility operations	–Canada	**60,811**	54,687	44,670	36,374	26,193
	–United States	**53,447**	44,216	38,467	31,770	26,042
		114,258	98,903	83,137	68,144	52,235
Propane and Petroleum products Canada	Propane	**93,050**	81,160	76,574	74,130	73,424
	Gasoline	**26,740**	37,006	39,371	51,112	44,342
	Light and residual fuels	**1,049**	840	4,448	2,959	2,991
	Merchandise and other	**29,246**	25,033	24,025	16,891	18,004
		150,085	144,039	144,418	145,092	138,761
United States	Propane	**13,148**	11,100	9,900	9,329	9,591
	Gasoline	**60,288**	45,664	38,540	37,563	42,034
	Light and residual fuels	**41,052**	26,672	22,313	17,442	17,733
	Merchandise and other	**10,475**	8,622	7,992	5,183	5,377
		124,963	92,058	78,745	69,517	74,735
Exploration and Production	–Canada	**12,005**	11,272	10,985	9,477	7,939
	–United States	**3,555**	2,640	2,459	2,560	2,150
		15,560	13,912	13,444	12,037	10,089
Manufactured products	–Canada	**28,471**	23,691	19,553	18,312	15,424
	–United States	**21,046**	17,463	15,294	17,282	17,746
		49,517	41,154	34,847	35,594	33,170
		454,383	390,066	354,591	330,384	308,990
OPERATING PROFIT						
Utility operations	–Canada	**7,670**	7,581	7,108	7,158	6,482
	–United States	**2,705**	2,471	2,234	1,900	2,641
		10,375	10,052	9,342	9,058	9,123
Propane and Petroleum products	–Canada	**14,886**	10,692	9,642	7,402	10,220
	–United States	**1,701**	913	2,723	2,267	2,498
		16,587	11,605	12,365	9,669	12,718
Exploration and Production	–Canada	**7,610**	6,712	6,710	4,499	2,820
	–United States	**1,693**	1,058	968	1,464	1,178
		9,303	7,770	7,678	5,963	3,998
Manufactured products	–Canada	**1,280**	1,325	984	587	587
	–United States	**1,772**	(557)	(696)	2,643	2,293
		3,052	768	288	3,230	2,880
Equity earnings in Canadian Homestead	(Exploration and Production)	**2,187**	1,740	1,310	791	661
		41,504	31,935	30,983	28,711	29,380

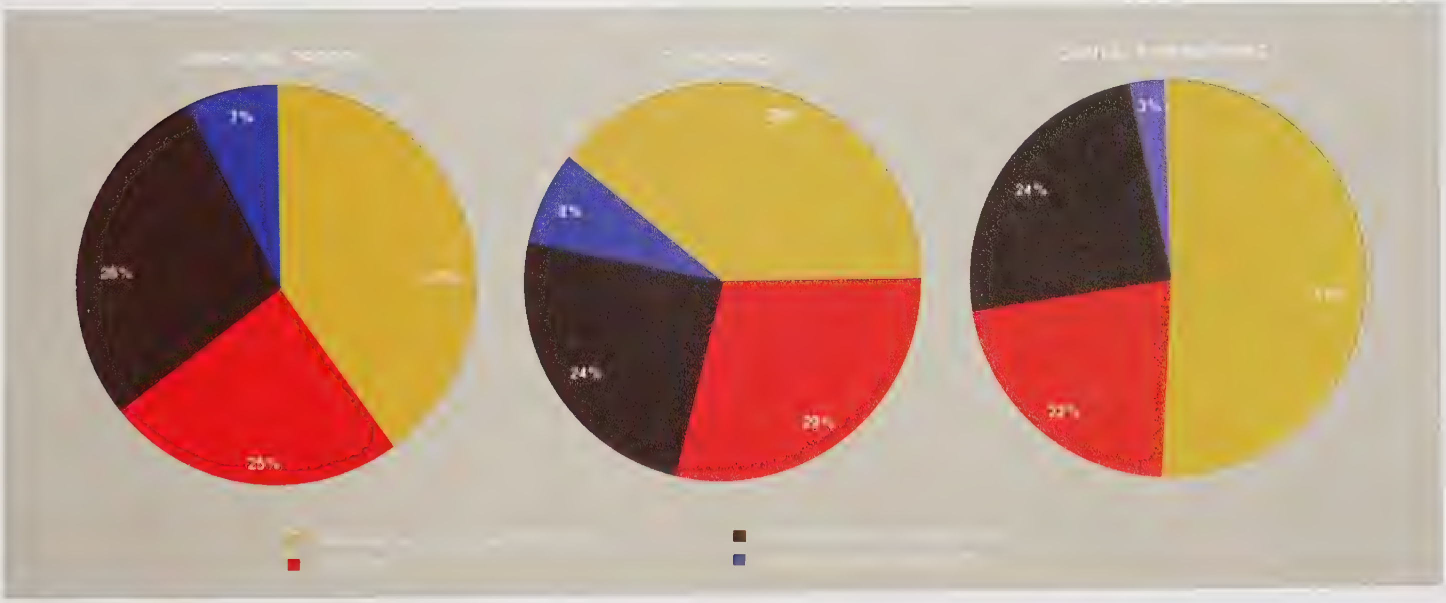
BUSINESS SEGMENTS

(continued)

The following financial information provides an analysis of the assets identified as belonging to a particular segment as at December 31, 1979 and 1978:

(in Thousands of Dollars)

		Total Assets		Capital Expenditures		Depreciation and Depletion Expenses	
IDENTIFIABLE ASSETS		**1979**	1978	**1979**	1978	**1979**	1978
Utility operations	–Canada	**80,169**	78,228	**5,623**	6,590	**1,629**	1,665
	–United States	**26,034**	24,075	**1,148**	700	**451**	334
		106,203	102,303	**6,771**	7,290	**2,080**	1,999
Propane and Petroleum products	–Canada	**94,738**	84,984	**11,426**	7,674	**4,926**	4,724
	–United States	**46,724**	40,808	**4,731**	7,031	**1,850**	1,091
		141,462	125,792	**16,157**	14,705	**6,776**	[illegible]
Exploration and Production	–Canada	**43,151**	39,432	**5,524**	4,484	**2,548**	2,892
	–United States	**10,387**	9,030	**1,840**	1,870	**779**	744
		53,538	48,462	**7,364**	6,354	[illegible]	[illegible]
Manufactured products	–Canada	**15,155**	14,799	**156**	239	**175**	184
	–United States	**13,636**	13,804	**750**	691	**342**	290
		28,791	28,603	**906**	930	**517**	[illegible]
TOTAL BUSINESS SEGMENTS		**329,994**	305,160	**31,198**	29,279	**12,700**	[illegible]
INVESTMENT IN CANADIAN HOMESTEAD (Exploration and Production)		**29,905**	23,685	–	–	–	–
CORPORATE ASSETS		**4,724**	4,219	**460**	363	**143**	86
		364,623	333,064	**31,658**	29,462	**12,843**	12,010



INTER-CITY GAS LIMITED
TEN YEAR SUMMARY OF OPERATIONS

(in Thousands of Dollars)

	1979	1978	1977	1976	1975	1974	1973	1972	1971	1970
Operating revenues	**454,383**	229,090	81,995	67,728	52,630	37,339	32,689	27,195	22,259	13,403
Operating expenses										
Cost of sales	**333,894**	169,441	58,160	48,560	36,603	25,001	22,585	18,979	15,942	9,226
Operating, selling and administration	**68,329**	33,555	9,943	8,409	6,941	5,384	4,713	3,854	3,006	1,984
Depreciation and depletion	**12,843**	7,076	3,258	2,215	1,648	919	797	668	568	410
	415,066	210,072	71,361	59,184	45,192	31,304	28,095	23,501	19,516	11,620
	39,317	19,018	10,634	8,544	7,438	6,035	4,594	3,694	2,743	2,783
Equity in net income of Canadian Hydrocarbons	–	1,758	2,852	1,207	–	–	–	–	–	–
Equity in net income of Canadian Homestead Oils	**2,187**	713	–	–	–	–	–	–	–	–
Operating profit	**41,504**	21,489	13,486	9,751	7,438	6,035	4,594	3,694	2,743	1,783
Financial Expenses	**19,285**	11,386	7,439	4,330	2,642	2,249	2,136	1,593	1,501	843
Income before income taxes	**22,219**	10,103	6,047	5,421	4,796	3,786	2,458	2,101	1,242	940
Income taxes	**9,312**	2,410	737	1,572	2,174	1,659	1,003	547	254	264
	12,907	7,693	5,310	3,849	2,622	2,127	1,455	1,554	988	676
Minority interest	**(968)**	(505)	–	–	–	–	(3)	(11)	(22)	–
Extraordinary items	**495**	121	(188)	–	–	–	–	–	–	–
Net income for the year	**12,434**	7,309	5,122	3,849	2,622	2,127	1,452	1,543	966	676
Dividends paid–										
Preference shares	**1,619**	1,335	1,100	903	713	537	352	362	292	221
Common shares	**2,372**	1,570	1,160	1,031	825	683	378	248	198	158
Net income per common share	**$1.43**	$1.21	$0.94	$0.73	$0.56	$0.45	$0.37	$0.43*	$0.26*	$0.18*
Dividends paid per common share	**.31**	.28	.27	.24	.24	.20	.12	.09*	.07½*	.06*
Fixed assets (at cost)	**289,244**	267,508	66,606	60,393	52,832	48,895	39,288	35,226	30,113	26,103
Shareholders' equity	**73,678**	61,454	29,972	27,598	18,784	17,729	12,808	11,022	9,873	7,577
Common shareholders' equity	**54,967**	42,657	17,431	14,549	9,625	8,413	7,503	5,615	4,345	3,952
Number of outstanding common shares	**7,889†**	7,162†	4,297	4,296	3,436	3,416	3,411	2,763*	2,648*	2,572*
Book value per share	**$6.97**	$5.96	$4.06	$3.39	$2.80	$2.46	$2.20	$2.03*	$1.64*	$1.54

*These figures have been adjusted to reflect two-for-one stock splits that took place in the years 1970, 1971 and 1973.
†After deducting shares held by a subsidiary company.

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheets of Inter-City Gas Limited as at December 31, 1979 and 1978 and the consolidated statements of income, retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1979 and 1978 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied after giving retroactive effect to the change in accounting for capital leases as outlined in Note 10, on a basis consistent with that of the preceding year.

CHARTERED ACCOUNTANTS

Coopers & Lybrand

Winnipeg, Manitoba
March 19, 1980

INTER-CITY GAS LIMITED
CONSOLIDATED STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 1979 AND 1978

(in Thousands of Dollars)

		1979	1978 (note 2)
OPERATING REVENUE	Sales and related income	**454,383**	390,066
OPERATING EXPENSES	Cost of sales	**333,894**	285,596
	Operating, selling and administrative expenses	**68,329**	62,265
	Depreciation and depletion	**12,843**	12,010
		415,066	359,871
		39,317	30,195
EQUITY EARNINGS IN NET INCOME OF CANADIAN HOMESTEAD OILS LIMITED (note 4)		**2,187**	1,740
OPERATING PROFIT		**41,504**	31,935
FINANCIAL EXPENSES	Interest on long-term debt	**12,466**	11,688
	Other interest	**7,098**	4,307
	Interest capitalized	**(1,793)**	(1,306)
	Amortization of financing expenses and goodwill	**615**	713
	Loss on foreign exchange	**899**	659
		19,285	16,061
INCOME BEFORE INCOME TAXES		**22,219**	15,874
PROVISION FOR INCOME TAXES	Current	**7,859**	2,912
(note 14)	Deferred	**1,453**	2,794
		9,312	5,706
INCOME AFTER INCOME TAXES		**12,907**	10,168
MINORITY INTEREST IN SUBSIDIARY COMPANIES			
EQUITY EARNINGS IN NET INCOME OF CANADIAN HYDROCARBONS LIMITED ATTRIBUTABLE TO COMMON SHARES HELD BY OTHERS PRIOR TO ACQUISITION BY INTER-CITY GAS LIMITED (note 2)		**70**	2,012
OTHER		**898**	968
		11,939	7,188
EXTRAORDINARY ITEMS	Provision for losses on investments in subsidiary companies, net of deferred income taxes of \$765,000; 1978 – \$512,000 (note 3a)	**(765)**	(511)
	Reduction of current income taxes on application of losses of prior years	**896**	632
	Gain on disposal of subsidiary company (note 3b)	**364**	—
		495	121
NET INCOME FOR THE YEAR		**12,434**	7,309
NET INCOME PER COMMON SHARE (note 15)	Before extraordinary items	**\$1.36**	\$1.19
	After extraordinary items	**\$1.43**	\$1.21

INTER-CITY GAS LIMITED
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
FOR THE YEARS ENDED DECEMBER 31, 1979 AND 1978

(in Thousands of Dollars)

		1979	1978 (note 2)
WORKING CAPITAL PROVIDED:	From operations (note 16)	**26,723**	21,421
	Extraordinary Items–		
	Reduction of income taxes	**896**	632
	Provision for losses in subsidiary companies	**(765)**	(511)
	Proceeds on disposal of subsidiary company (note 3b)	**3,800**	—
		30,654	21,542
	Proceeds from sale of property, plant and equipment	**3,770**	3,059
	Proceeds from issue of third preference shares Series A	—	6,500
	Proceeds from issue of common shares	**3,867**	775
	Long-term debt issued	**7,586**	10,739
	Notes and mortgages, customer contributions and other	**1,413**	2,651
	Proceeds from sale of preferred shares of Canadian Hydrocarbons Limited	—	4,816
		47,290	50,082
WORKING CAPITAL APPLIED:	Additions to property, plant and equipment	**31,658**	29,642
	Repayment of long-term debt	**14,126**	12,056
	Dividends to shareholders and to minority interests	**4,675**	4,273
	Cost of shares in Canadian Homestead Oils Limited	**3,764**	1,502
	Notes and mortgages, other assets and deferred costs	**2,429**	2,074
	Redemption of preference shares	**86**	259
	Employee share purchase plan loans (net)	**412**	862
	Shares in and advances to affiliated companies	**1,213**	—
	Purchase of minority interest common shares and redemption of preference shares held by minority interests	**3,596**	431
	Discontinued operations	—	1,213
		61,959	52,312
INCREASE IN WORKING CAPITAL DEFICIENCY (note 16)		**14,669**	2,230
WORKING CAPITAL DEFICIENCY–Beginning of year		**22,805**	20,575
WORKING CAPITAL DEFICIENCY–End of year		**37,474**	22,805
	Working capital deficiency is represented by:		
	Current liabilities	**161,940**	135,519
	Current assets	**124,466**	112,714
		37,474	22,805

INTER-CITY GAS LIMITED
CONSOLIDATED BALANCE SHEET
AS AT DECEMBER 31, 1979 AND 1978

(in Thousands of Dollars)

ASSETS

		1979	1978
CURRENT ASSETS	Cash and short-term deposits	**11,918**	8,440
	Accounts and notes receivable (note 5)	**73,754**	62,375
	Income taxes recoverable	**1,385**	5,125
	Inventories (notes 5 and 6)	**36,528**	35,437
	Prepaid expenses	**881**	1,337
		124,466	112,714
INVESTMENTS	Shares of Canadian Homestead Oils Limited (note 4)	**29,905**	23,685
	Shares in and advances to affiliated companies (note 7)	**1,213**	—
	Employee share purchase plan loans (note 8)	**2,058**	1,646
	Notes and mortgages	**2,297**	2,159
		35,473	27,490
FIXED ASSETS (notes 5, 9 and 10)	Property, plant and equipment – at cost	**289,244**	267,508
	Accumulated depreciation and depletion	**88,359**	78,529
		200,885	188,979
OTHER ASSETS AND DEFERRED CHARGES – at cost less amortization–	Financing expenses	**2,302**	2,384
	Rate hearings and other	**1,339**	1,181
	Goodwill	**158**	316
		3,799	3,881
		364,623	333,064

Signed on behalf of the Board

[signature], *Director* [signature], *Director*

(in Thousands of Dollars)

LIABILITIES

		1979	1978
CURRENT LIABILITIES	Bank advances (note 5)	**66,736**	52,096
	Accounts payable and accrued liabilities	**73,295**	60,983
	Income taxes payable	**2,358**	1,981
	Current portion of long-term debt	**14,057**	16,234
	Deferred income and deposits	**5,494**	4,225
		161,940	135,519
LONG-TERM DEBT (notes 5 and 11)		**93,539**	100,217
CUSTOMERS' CONTRIBUTIONS IN AID OF CONSTRUCTION		**1,013**	504
DEFERRED INCOME TAXES (note 14)		**21,824**	19,168
MINORITY INTERESTS IN SUBSIDIARIES (note 12)		**12,629**	16,202
		290,945	271,610

SHAREHOLDERS' EQUITY

		1979	1978
STATED CAPITAL (note 13)	Authorized–		
	600,000 first preference shares issuable in series		
	262,468 second preference shares issuable in series		
	10,000,000 third preference shares issuable in series		
	20,000,000 common shares		
	Issued and fully paid–		
	239,450 first preference shares Series B (1978 –239,450)	**4,789**	4,789
	200,000 first preference shares Series C (1978 –200,000)	**4,000**	4,000
	88,418 second preference shares Series A (1978 –90,518)	**1,768**	1,810
	82,685 second preference shares Series B (1978 –84,885)	**1,654**	1,698
	100,000 third preference shares Series A (1978 –100,000)	**6,500**	6,500
	8,926,568 common shares (1978–8,199,183)	**42,024**	38,157
		60,735	56,954
RETAINED EARNINGS		**23,316**	14,873
		84,051	71,827
COMMON SHARES OF INTER-CITY GAS LIMITED HELD BY A SUBSIDIARY COMPANY, 1,037,250 SHARES–at cost		**10,373**	10,373
		73,678	61,454
		364,623	333,064

INTER-CITY GAS LIMITED
CONSOLIDATED STATEMENT OF RETAINED EARNINGS
FOR THE YEARS ENDED DECEMBER 31, 1979 AND 1978

(in Thousands of Dollars)

		1979	1978
BALANCE–Beginning of year	As previously reported	**14,907**	10,484
	Less–adjustment for change in accounting for capital leases (note 10)	**34**	15
	As restated	**14,873**	10,469
	Net income for the year	**12,434**	7,309
		27,307	17,778
	Dividends paid–		
	First preference shares Series B	**395**	401
	First preference shares Series C	**420**	420
	Second preference shares Series A	**117**	120
	Second preference shares Series B	**126**	131
	Third preference shares Series A	**561**	263
	Common shares	**2,372**	1,570
		3,991	2,905
BALANCE–End of year		**23,316**	14,873

INTER-CITY GAS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 1979 AND 1978

1. SIGNIFICANT ACCOUNTING POLICIES

Consolidation
The consolidated financial statements include the assets, liabilities and operating results of all subsidiary companies and have been prepared in accordance with generally accepted accounting principles in Canada which differ in certain respects with accounting principles in the United States. These differences are described further in the Company's annual report on Form 10-K filed with the Securities and Exchange Commission. The accounts of subsidiary companies are consolidated from the dates of acquisition on the basis of purchase accounting. The amounts by which the purchase price of subsidiary companies exceeds the fair value of the assets acquired have been treated as goodwill and are being amortized on a straight line basis over ten and twenty years.

Foreign Exchange
The accounts of subsidiaries and divisions operating in the United States are translated into Canadian dollars at the rates of exchange on the balance sheet date for current assets and current liabilities, on the date of the transaction for other balance sheet accounts and at the average rate for the year for revenues and expenses. Gains and losses on translation are reflected in income. The rate of exchange as at December 31, 1979 was \$1.1691 Cdn. = \$1.00 U.S. (1978–\$1.1858 Cdn. = \$1.00 U.S.) and the average exchange rate for the year was \$1.1715 Cdn. = \$1.00 U.S. (1978–\$1.1402 Cdn. = \$1.00 U.S.)

Fixed Assets
Fixed assets are recorded at cost which includes interest and overhead amounts capitalized during the construction period, and also includes the full cost method of accounting for oil and gas properties.

Depreciation is provided on a straight line basis at the following rates based on the estimated useful lives of the applicable assets:

Buildings	— 2½%—10%
Transmission lines & distribution systems	— 1% — 5%
Customer installations	— 2% — 5%
Refineries and gas plants	— 7% —10%
Transportation equipment	—18% —30%
Machinery, equipment and furniture	—10% —20%

Fixed assets leased under capital leases are capitalized and depreciated on the same basis and rates as above.

Depletion of oil and gas properties and depreciation of well equipment and gathering systems are provided on a unit of production method based on estimated recoverable reserves. Limited term interests in oil and gas leases are depleted over their remaining terms.

Inventories
Inventories of propane and other petroleum products are valued at the lower of cost (first-in, first-out) and replacement cost except for certain United States subsidiaries which price these inventories on the last-in, first-out method. Inventories of merchandise, materials, and supplies are valued at the lower of cost and net realizable value. Cost is determined for work-in-process and finished goods at standard prices and for raw materials and supplies on a first-in, first-out basis.

Investments
The Company accounts for its investment in Canadian Homestead Oils Limited by the equity method (see also note 4). Other investments are stated at cost.

Deferred Charges
Amortization of financing expenses is provided on a straight line method over the terms of the respective issues and the amortization of other deferred charges is provided on a straight line method over periods of three to twenty years.

Income Taxes
Regulatory agencies have directed certain subsidiaries in the utilities operations to provide only those income taxes currently payable in their financial statements and in the calculation of their rates of return for rate making purposes. However, for all other operations, the Company provides for deferred income taxes on all timing differences between accounting income and taxable income, including those relating to its exploration, development and acquisition of petroleum and natural gas properties.

2. ACQUISITION OF CANADIAN HYDROCARBONS LIMITED AND COMPARATIVE FIGURES

In February, 1979, the Company completed its acquisition of all of the outstanding common shares of Canadian Hydrocarbons Limited by acquiring the remaining 74,129 outstanding shares in exchange for 111,193 Inter-City shares.

In order to provide an appropriate basis of comparison with the current year's operations, the Consolidated Statements of Income and Changes in Financial Position for the year ended December 31, 1978 have been restated to include the operations of Canadian Hydrocarbons Limited as though it had been acquired at the beginning of the year with a deduction to reflect the pre-acquisition earnings applicable to common shares held by others prior to acquisition by Inter-City.

In addition, fixed assets and deferred income taxes were increased \$3,349,000 to reflect the final adjustments arising from the acquisition.

INTER-CITY GAS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 1979 AND 1978 (continued)

The following pro forma information shows results from operations as though the Company had acquired its 100% interest as of January 1:

	1979	1978
	($000)	($000)
Net income for the year per the consolidated statement of income	**12,434**	7,309
Add—minority interest in equity earnings of Canadian Hydrocarbons Limited (less minority share of extraordinary items, 1979—nil; 1978—$162,000	**70**	1,850
	12,504	9,159
Dividends on preference shares	**1,619**	1,335
Net income to common shares	**10,885**	7,824
Weighted average number of common shares outstanding	**7,586,674**	7,201,626
Basic net income per common share—		
Before extraordinary items	**$1.37**	$1.10
After extraordinary items	**$1.44**	$1.09

3. INVESTMENT IN SUBSIDIARY COMPANIES

a. On February 18, 1980, the Company agreed to sell its refinery and natural gas processing plant in Cut Bank, Montana and its gasoline and propane retail outlets located in the north-western United States. The Company also agreed to grant an option for the sale of both the Williston Refinery and certain oil and gas-producing properties located in North Dakota and Montana. If the option is exercised, the Company will have a farm-in agreement which will entitle it to continue exploration on these properties. The net consideration for the sale and option agreements is approximately $27,600,000 (U.S.) of which $11,000,000 is due in 1980; $6,600,000 is due in 1981 and $10,000,000 is due over the period 1982 to 1989. The Company expects that the option will be exercised and the total transaction closed on April 1, 1980. Any amounts due after that date bear interest at the rate of 13½%.

The following schedule shows the relevant contributions to the consolidated statement of income and balance sheet for the years ended December 31:

	1979	1978
	Cdn. ($000)	Cdn. ($000)
Operating revenues	**126,735**	93,102
Net income (loss) after taxes	**(37)**	235
Current assets	**22,959**	18,425
Current liabilities	**27,093**	15,020
Working capital (deficiency)	**(4,134)**	3,405
Fixed assets–net book value	**28,262**	24,408

A provision of $765,000 (net of income taxes) has been made for the estimated loss on sale of these operations.

b. In April, 1979, the Company sold its shares in one of its subsidiaries, Pay-N-Save Gas Stations Ltd. for $3,800,000 cash. This company, which formed part of the Propane and Petroleum Products (Canada) business segment, operated retail gasoline stations in the province of British Columbia and accounted for revenues of $7,641,000 in 1979 and $20,642,000 in 1978.

4. INVESTMENT IN CANADIAN HOMESTEAD OILS LIMITED

Under the terms of an agreement between ICG Canadian Propane Ltd. (ICG Propane–formerly Canadian Propane Gas & Oil Ltd.) a subsidiary company and Canadian Homestead Oils Limited (Canadian Homestead), ICG Propane is committed to expenditures of $18,212,000 and will receive as consideration 3,018,201 shares of Canadian Homestead.

ICG Propane is required to expend annually a minimum of $1,500,000 but not more than $3,070,000 until the full commitment has been met. Total expenditures to December 31, 1979 were $17,372,000 which has earned ICG Propane a total of 2,892,098 common shares of Canadian Homestead, of which 37,735 were unissued at December 31. The Company also owns 629,900 of the outstanding common shares of Canadian Homestead through its 87.5% interest in Castle Oil & Gas Limited. In total, the Company owns 3,638,373 common shares (49.7%) of Canadian Homestead and at December 31, 1979, had an effective interest of 48.6%. For accounting purposes, the Company has recorded this effective interest on the equity method.

In May, 1979, the Company announced plans for a proposed amalgamation with Canadian Homestead on the basis of one and four-tenths common shares of the amalgamated company for each common share of Canadian Homestead and one common share of the amalgamated company for each common share of Inter-City.

A Joint Management Proxy Statement and Information Circular was mailed on March 4, 1980 to the shareholders of each of Inter-City and Canadian Homestead along with Notices of Special General Meetings of Shareholders of each company, to be held on March 28, 1980, at which time the shareholders of each company will be asked to consider and, if thought advisable, to pass special resolutions approving the amalgamation.

If the amalgamation becomes effective, the agreement with ICG Propane will be terminated.

5. SECURITY FOR BANK ADVANCES, TERM LOANS AND OTHER LONG-TERM INDEBTEDNESS

Current bank loans, term bank loans and other long-term indebtedness are generally secured by a pledge of inventories, accounts receivable, production proceeds, certain shares of subsidiary and affiliated companies, certain fixed assets and interest in certain petroleum and natural gas properties.

The Company and its subsidiaries have lines of credit with Canadian and United States banks totalling $75,566,000 (1978–$70,716,000) of which $66,736,000 has been used at December 31, 1979 (1978–$52,096,000).
The weighted average interest on the outstanding bank advances at December 31, 1979 was 15.11% (1978–11.63%). Weighted average interest rates are calculated based on actual interest rates in effect and the bank advances outstanding as at December 31. The maximum amount of bank advances outstanding at any month-end during the year ended December 31, 1979 was $66,736,000 (1978–$64,200,000).
The average bank advances outstanding, calculated by averaging month-end balances, during the year ended December 31, 1979 was $53,575,000 (1978–$50,171,000) and the approximate weighted average interest rate on these bank advances was 12.75% for the year ended December 31, 1979 (1978–9.75%). Weighted average interest rates are calculated based on the average interest rates and average loan balances outstanding.

6. INVENTORIES

Inventories are classified as follows:

	1979	1978
	($000)	($000)
Propane and petroleum products	**8,552**	9,725
Raw materials	**5,164**	5,896
Work-in-process	**1,681**	1,853
Finished goods	**6,478**	5,544
Merchandise, materials and supplies	**14,653**	12,419
	36,528	35,437

Propane and petroleum products priced on the last-in, first-out method amounted to $2,920,000 at December 31, 1979 ($4,082,000 at December 31, 1978) which is approximately $6,702,000 below replacement cost ($3,340,000 at December 31, 1978).

7. SHARES IN AND ADVANCES TO AFFILIATED COMPANIES

The Company holds interests in two corporations which were incorporated during 1979 to seek franchises to distribute natural gas in the province of Nova Scotia and in certain unserved areas in the province of Quebec. The ability to proceed with these developments is predicated among other things on the outcome of current applications by other parties before the National Energy Board of Canada for the construction of natural gas transmission lines east of Montreal. No decision with respect to the construction of this pipeline or the granting of the franchises has been made at the present time. The Company's share of costs of preliminary investigative work and other costs associated with the application for these franchises is reflected in the balance sheet as advances to affiliated companies.

The balance at December 31, 1979 is comprised of:

	($000)
Shares	$ 25
Advances	1,188
	$1,213

8. SHARE PURCHASE PLAN

During 1979, 130,000 common shares (1978–115,000) were purchased by employees from Trustees of the share purchase plan. During the year, $662,000 was repaid by employees to the Company and the balance due from the employees at December 31, 1979 amounted to $2,058,000 (1978–$1,646,000). These loans are non-interest bearing.

9. FIXED ASSETS

Property, plant and equipment are classified as follows:

	1979			1978
	Cost	Accumulated Depreciation and Depletion	Net Book Value	Net Book Value
	($000)	($000)	($000)	($000)
Land	**4,368**		**4,368**	5,608
Buildings	**15,925**	**4,269**	**11,656**	10,793
Transmission lines and distribution system	**87,675**	**12,362**	**75,313**	69,224
Customer installations	**43,754**	**21,477**	**22,277**	22,116
Refineries and gas plants	**28,964**	**9,264**	**19,700**	14,621
Petroleum and natural gas properties, leases and exploration costs	**55,647**	**17,590**	**38,057**	35,477
Well equipment and gathering systems	**7,915**	**2,415**	**5,500**	7,324
Transportation equipment	**16,825**	**9,097**	**7,728**	7,106
Machinery and equipment and furniture	**28,171**	**11,885**	**16,286**	16,710
	289,244	**88,359**	**200,885**	188,979

10. CAPITAL LEASES

The Company has adopted the policy of capitalizing assets leased under capital leases whereby the fair value of the assets leased and the related lease obligations are reflected in the balance sheet as fixed assets and long-term debt, respectively. This policy was applied retroactively to include capital leases entered into prior to 1979 and is consistent with the recommendations of the Canadian Institute of Chartered Accountants which became effective for fiscal years commencing on or after January 1, 1979.

The effect of the change has been to decrease retained earnings as at January 1, 1978 by $15,000 (net of deferred

income taxes of $15,000) and to decrease net income for the year ended December 31, 1978 by $19,000 (net of deferred income taxes of $18,000). For the year ended December 31, 1979, the change has resulted in a decrease in net income of $30,000 (net of deferred income taxes of $26,000).

Details of assets leased under capital leased and included in fixed assets are as follows:

	1979			1978
	Cost	Accumulated Depreciation and Depletion	Net Book Value	Net Book Value
	($000)	($000)	($000)	
Customer installations	**2,188**	**1,096**	**1,092**	1,202
Transportation equipment	**2,860**	**581**	**2,342**	414
	5,048	**1,614**	**3,434**	1,616

11. LONG-TERM DEBT

The details of long-term debt are as follows:

	1979	1978
	($000)	($000)
Term bank loans, secured, bearing interest at rates varying from ½% to 1½% over the bank prime rate repayable during the period 1980 to 1984	**41,191**	51,067
Production bank loans, secured, bearing interest at rates of prime times 122.5% repayable during the period of 1980 to 1981	**6,530**	7,507
Sinking fund debentures bearing interest at rates varying from 6% to 11% due in the years 1981 to 1994	**19,848**	17,463
First mortgage bonds issued in series bearing interest at rates varying from 6% to 9½% due in the years 1982 to 1994	**6,887**	7,371
Subordinated debentures bearing interest at 5% due 1990	**7,039**	7,510
Promissory notes bearing interest at rates varying from 7% to 10¾% due in the years 1980 to 1995	**19,772**	22,097
Sundry notes and mortgages	**2,358**	1,290
Capitalized lease obligations bearing interest at various rates averaging 12% repayable during the period 1980 to 1992 (see note 10)	**4,021**	2,146
	107,596	116,451
Current maturities included in current liabilities	**14,057**	16,234
	93,539	100,217

Amounts rėpayable in United States funds are translated into Canadian funds at the historical exchange rates in effect at their respective dates of issue except for current maturities which are translated at the year-end exchange rate. If all amounts repayable in United States funds were translated at the exchange rate in effect at year-end, it would result in an increase in long-term debt of approximately $6,270,000 at December 31, 1979 ($8,200,000 at December 31, 1978).

Under the provisions of the various agreements and indentures, excluding capitalized lease obligations, the Company is required to make the following instalments during the next five years:

Year	($000)
1980	13,454
1981	27,063
1982	9,800
1983	11,910
1984	5,119

Minimum lease payments required under capital leases are as follows:

Year	($000)
1980	991
1981	934
1982	863
1983	812
1984	700
subsequent years	1,434
Total minimum lease payments	5,734
Less–amount representing interest at 12%	1,713
Balance of capitalized lease obligations	4,021

12. MINORITY INTERESTS IN SUBSIDIARIES

The minority interests are comprised of the following:

	1979	1978
	($000)	($000)
Preferred shares in Canadian Hydrocarbons Limited and ICG Utilities Ltd. (formerly Great Northern Gas Utilities Ltd.)	**11,565**	11,824
Equity interest in–		
Inter-City Manufacturing Ltd.	**21**	40
Canadian Hydrocarbons Limited	–	1,069
Fort St. John Petroleums Limited	**330**	2,605
Castle Oil & Gas Limited	**713**	664
	12,629	16,202

13. STATED CAPITAL

(a) Authorized

The first preference shares have been designated as 265,000 Series B shares carrying a cumulative dividend entitlement of $1.65 per share and are currently redeemable at $22.00 per share; and 200,000 Series C shares carrying a cumulative dividend entitlement of $2.10 per share and currently redeemable at $22.00 per share.

The second preference shares have been designated as 97,268 Series A shares carrying a cumulative dividend entitlement of $1.30 per share and redeemable at a price not to exceed $20.63 per share; and 90,200 Series B shares carrying a cumulative dividend entitlement of $1.50 per share and are currently redeemable at $21.20 per share to June 1, 1980 and $21.05 thereafter.

The third preference shares have been designated as 100,000 Series A shares, carrying a cumulative dividend entitlement at a fluctuating rate equal to one-half of the bank prime rate plus 2¼% and are redeemable in full on June 1, 1988.

(b) Purchase funds

The preference shares have various purchase fund requirements as follows:

First Preference Shares Series B
To purchase annually 7% of the original issue amount for each of the years 1980 and 1981, 13% for each of the years 1982 to 1986 and 5% for each year thereafter. No shares were cancelled in 1979 (1978—7,000).

First Preference Shares Series C
To offer to purchase annually 7% of the original issue amount for each of the years 1980 and 1981, 13% for each of the years 1982 to 1986 and 5% for each year thereafter. No shares were cancelled in 1979 or 1978.

Second Preference Shares Series A and B
To purchase annually in the market, a minimum of 3% of the original issue amount outstanding at the end of the preceding year. In 1979, 2,100 Series A and 2,200 Series B shares were purchased and cancelled (1978—3,750 and 2,200).

Third Preference Shares Series A
There are no purchase fund requirements attached to these shares.

The minimum purchase requirements for all series in the next five years are as follows:

Year	($000)
1980	756
1981	752
1982	1,308
1983	1,304
1984	1,302

(c) Common shares

During the year, the Company issued 111,193 common shares with a fair value of $1,001,000 in exchange for 74,129 shares of Canadian Hydrocarbons Limited; 488,192 shares upon the exercise of warrants at $3.50 per share; and 128,000 shares under the share purchase plan for $1,152,000.

(d) Warrants

The Company has reserved 107,048 common shares for the exercise of share purchase warrants at $3.50 per share up to July 31, 1981.

14. INCOME TAXES

A reconciliation between the statutory and the effective rate of income taxes is provided as follows:

	1979 ($000)	1978 ($000)
Combined federal and provincial income taxes at 46% on income less equity income in Canadian Homestead Oils Limited	**9,215**	6,502
Increase (decrease) in income taxes resulting from—		
Regulated natural gas divisions	**69**	(89)
Alberta royalty credits	**(1,000)**	(1,019)
Provincial and foreign taxes in excess of federal abatement	**1,028**	312
Effective income taxes	**9,312**	5,706

If tax allocation had been followed in respect of all timing differences between accounting income and taxable income, the provision for deferred income taxes would have decreased and consolidated net income would have increased by $69,000 (1978—decrease in net income of $89,000). At December 31, 1979, the accumulated deferred income taxes would have amounted to approximately $3,904,000 (1978—$3,973,000), in addition to the amounts recorded in the accounts.

15. NET INCOME PER COMMON SHARE

The net income per common share is calculated on the weighted average number of shares outstanding during the respective years as follows:

	1979 ($000)	1978 ($000)
Net income for the year	**12,434**	7,309
Less—dividends on preference shares	**1,619**	1,335
Net income available to common shares	**10,815**	5,974

INTER-CITY GAS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 1979 AND 1978 (continued)

Weighted average number of shares outstanding during the year	**8,605,390**	5,634,175
Less—weighted average of reciprocal shareholding	**1,034,655**	690,462
	7,570,735	4,943,713
Basic net income per common share		
Before extraordinary items	**$1.36**	$1.19
Extraordinary items	**$0.07**	$0.02
After extraordinary items	**$1.43**	$1.21
Fully diluted net income per common share (treasury stock method)		
Before extraordinary items	**$1.35**	$1.11
Extraordinary items	**$0.06**	$0.02
After extraordinary items	**$1.41**	$1.13

Under the treasury stock method fully diluted net income per common share is computed by increasing the average number of common shares outstanding during the year by the number of common shares to be issued on the exercise of warrants less the number of common shares that can be purchased in the open market with the proceeds from the exercise. For purposes of the calculation, it is assumed all warrants are exercised on January 1 and that shares are purchased on the open market at the average share price for the year.

16. STATEMENT OF CHANGES IN FINANCIAL POSITION

(a) Working capital provided from operations is computed as follows:

	1979	1978
	($000)	($000)
Net income before extraordinary items	**11,939**	7,188
Add (Deduct) items not affecting working capital		
Depreciation & depletion	**12,843**	12,010
Amortization of other assets & deferred charges	**1,361**	821
Deferred income taxes	**2,439**	2,517
Equity in earnings of Canadian Homestead Oils Limited	**(2,187)**	(1,740)
Gain on disposal of property, plant and equipment	**(640)**	(2,355)
Minority interest in subsidiaries		
Canadian Hydrocarbons Limited	**70**	2,012
Other	**898**	968
	26,723	21,421

(b) The increase in the working capital deficiency is represented by:

	1979	1978
	($000)	($000)
Increase (Decrease) in current assets—		
Cash	**3,478**	(4,168)
Accounts and notes receivable	**11,379**	(946)
Income taxes recoverable	**(3,740)**	4,848
Inventories	**1,091**	2,665
Prepaid expenses	**(456)**	(75)
	11,752	2,324
Increase (Decrease) in current liabilities—		
Bank advances	**14,640**	2,590
Accounts payable and accrued liabilities	**12,312**	3,092
Income taxes payable	**377**	783
Current portion of long-term debt	**(2,177)**	(4,081)
Deferred income and deposits	**1,269**	2,170
	26,421	4,554
	14,669	2,230

17. LEASE COMMITMENTS

The approximate aggregate minimum annual rentals under long-term leases at December 31, 1979, excluding capital leases, are as follows:

Year	($000)
1980	2,826
1981	2,280
1982	1,880
1983	1,711
1984	1,449
subsequent years	3,881
	14,027

18. PENSION PLANS

The Company has various pension plans available to certain groups of permanent full-time employees. The Company makes contributions to the plans based on salary levels and the cost to the Company was $549,000 for the year ended December 31, 1979 (1978—$514,000). Unfunded liabilities for past service benefits at December 31, 1979 was nil for the Canadian plans and approximately $1,283,000 (U.S.) for the United States plans (1978—nil and $1,166,000-U.S., respectively). In addition, the United States plans have a deficiency of approximately $584,000 (U.S.) in the actuarily computed value of vested benefits over pension plan assets (1978—$545,000 U.S.).

19. QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized quarterly financial data is as follows:

	Three Months Ended				Year Ended
1979	March 31	June 30	September 30	December 31	December 31
Operating revenue	123,087	93,394	98,646	139,256	454,383
Gross profit	36,618	26,620	21,108	36,143	120,489
Net income (loss) after dividends on preference shares	6,106	1,918	(1,722)	4,513	10,815
Basic net income (loss) per common share					
–before extraordinary items	$0.85	$0.19	$(0.23)	$0.55	$1.36
–after extraordinary items	$0.85	$0.24	$(0.23)	$0.57	$1.43
1978					
Operating revenue	103,467	82,585	86,258	117,756	390,066
Gross profit	30,443	21,996	20,205	31,826	104,470
Net income (loss) after dividends on preference shares	2,855	(184)	(1,101)	4,404	5,974
Basic net income (loss) per common share					
–before extraordinary items	$0.76	$(0.01)	$(0.32)	$0.76	$1.19
–after extraordinary items	$0.76	$(0.05)	$(0.32)	$0.82	$1.21

20. REMUNERATION OF DIRECTORS AND SENIOR OFFICERS

	1979	1978
(a) Number of directors during the year	**7**	7
(b) Remuneration as directors	**$ 35,000**	$ 5,000
(c) Number of officers during the year	**9**	7
(d) Remuneration as officers	**$713,000**	$527,000
(e) Number of directors who were also officers	**2**	4

21. BUSINESS SEGMENTS

An analysis of certain financial information by business lines and geographical areas for the five years ended December 31, 1979 as it relates to revenue and operating profit and as at December 31, 1979 and 1978 as it relates to identifiable assets is included elsewhere in this annual report and is incorporated herein by reference. Financial information for the years 1976 and 1975 is unaudited.

Intersegment sales are not material and are accounted for at prices comparable to normal, unaffiliated customers. Operating profit is total revenue less operating expenses which includes an allocation of corporate expenses. Identifiable assets include only those assets directly identifiable with those operations. Corporate assets consist primarily of employee share purchase plan loans, leasehold improvements, furniture and fixtures and deferred financing expenses.

22. OIL AND GAS PRODUCING ACTIVITIES

Information with respect to the oil and gas producing activities of the Company not included elsewhere in these financial statements, is presented as follows:

(a) Capitalized Costs–
As at December 31, 1979, aggregate capitalized costs and related accumulated depreciation and depletion, by geographic area, are:

	Cost		Depreciation and Depletion	
	Canada	U.S.	Canada	U.S.
	($000)	($000)	($000)	($000)
Petroleum and natural gas rights and intangible drilling costs–				
–proved properties	30,818	15,729	–	
–unproved properties	7,900	1,200	– 11,131	6,459
	38,718	16,929	11,131	6,459
Wellhead, gas plant and gathering systems	11,302	136	3,144	68
	50,020	17,065	14,275	6,527

(b) Expenditures–
Costs incurred in oil and gas producing activities for the years ended December 31, 1979 and 1978, by geographic area, were:

	1979		1978	
	Canada	U.S.	Canada	U.S.
	($000)	($000)	($000)	($000)
Property acquisition	**399**	**191**	238	–
Exploration	**949**	**–**	1,446	1,650
Development	**1,473**	**1,025**	1,865	199
Production	**1,376**	**900**	1,253	593

Unaudited information on reserves by geographical areas, future net revenues and results of operations on the basis of Reserve Recognition Accounting is included in the Company's annual report on Form 10-K.

23. SUPPLEMENTARY INFORMATION ON INFLATION AND CHANGING PRICES (UNAUDITED)

The accompanying consolidated financial statements reflect historical costs in accordance with generally accepted accounting principles. Because of inflation, the current costs of replacing inventories and productive capacity is estimated to be substantially greater than historical cost. Consequently, during times of significant and continued inflation, historical cost accounting does not reflect the cumulative effects of increasing prices and changes in the purchasing power of the dollar. Charges to earnings for the cost of inventories sold and depreciation and depletion of property, plant and equipment are made at historical dollar amounts even though the purchasing power of the dollar has declined significantly since these assets were acquired, particularly for property, plant and equipment.

The Financial Accounting Standards Board in the United States has recommended that supplementary information should be presented in financial statements in an attempt to measure the impact of inflation on the Company's operations. This information is included in the Company's annual report on Form 10-K.

CANADIAN HOMESTEAD OILS LIMITED
CONSOLIDATED BALANCE SHEETS
AS AT DECEMBER 31, 1979 AND 1978

(in Thousands of Dollars)

ASSETS

		1979	1978
CURRENT ASSETS	Cash and short term deposits	**325**	4,754
	Accounts receivable	**7,221**	3,527
	Alberta royalty tax credit receivable	**855**	625
	Inventory of supplies–at lower of cost and replacement cost	**509**	660
	Total current assets	**8,910**	9,566
PROPERTY, PLANT AND EQUIPMENT (Note 2)		**61,140**	42,705
LONG TERM RECEIVABLES AND OTHER ASSETS (Note 4)		**1,635**	1,777
		71,685	54,048
LIABILITIES			
CURRENT LIABILITIES	Bank loan	—	400
	Accounts payable and accrued liabilities	**8,492**	5,323
	Long term debt due within one year	**1,200**	653
	Total current liabilities	**9,692**	6,376
LONG TERM DEBT (Note 3)		**10,800**	5,000
DEFERRED REVENUE		**240**	—
DEFERRED INCOME TAXES		**7,693**	5,874
SHAREHOLDERS' EQUITY			
SHARE CAPITAL (Note 4)	Authorized Common–$.10 par value–7,500,000 shares Preferred–$10.00 par value–250,000 shares Issued and Outstanding Common shares–7,285,430 shares (1978–6,900,180 shares)	**729**	690
	6% Cumulative Redeemable Convertible Sinking Fund Preferred Shares–Nil shares		
CONTRIBUTED SURPLUS (Note 4)		**25,176**	22,683
CAPITAL REDEMPTION RESERVE FUND		**71**	71
RETAINED EARNINGS		**17,284**	13,354
		43,260	36,798
		71,685	54,048

See accompanying notes.

Signed on behalf of the Board

Director

Director

CANADIAN HOMESTEAD OILS LIMITED
CONSOLIDATED STATEMENTS OF EARNINGS
FOR THE YEARS ENDED DECEMBER 31, 1979 AND 1978

(in Thousands of Dollars)

		1979	1978
REVENUE	Oil and gas production	**10,936**	8,127
	Interest and other	**605**	422
		11,541	8,549
EXPENSES	Production and operating	**2,074**	1,410
	General and administrative	**1,484**	1,265
	Interest on short term debt	**223**	21
	Interest on long term debt	**960**	128
	Depreciation	**555**	422
	Depletion	**1,420**	977
		6,716	4,223
EARNINGS BEFORE INCOME TAXES		**4,825**	4,326
INCOME TAXES	Deferred	**1,750**	1,647
	Alberta royalty tax credit	**(855)**	(625)
		895	1,022
NET EARNINGS		**3,930**	3,304
NET EARNINGS PER COMMON SHARE (Note 8)	Basic	**55¢**	50¢
	Fully diluted	**54¢**	47¢

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

RETAINED EARNINGS AT BEGINNING OF YEAR	**13,354**	10,050
NET EARNINGS	**3,930**	3,304
RETAINED EARNINGS AT END OF YEAR	**17,284**	13,354

See accompanying notes.

CANADIAN HOMESTEAD OILS LIMITED
CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION
FOR THE YEARS ENDED DECEMBER 31, 1979 AND 1978 (in Thousands of Dollars)

		1979	1978
SOURCE OF FUNDS	Funds generated from operations	**7,695**	6,395
	Issue of common shares	**2,532**	3,211
	Proceeds on sales of properties and equipment	**1,230**	14
	Proceeds from long term debt	**7,000**	5,000
	Deferred revenue	**240**	—
	Reduction of long term receivables	**83**	—
	Other	**90**	—
	Total source of funds	**18,870**	14,620
USE OF FUNDS	Property, plant and equipment	**21,642**	11,283
	Reduction of long term debt	**1,200**	807
	Long term receivables	—	1,445
	Other investments	—	14
	Total use of funds	**22,842**	13,549
INCREASE (DECREASE) IN WORKING CAPITAL		**(3,972)**	1,071
WORKING CAPITAL CHANGES	Increase (Decrease) in current assets		
	Cash and short term deposits	**(4,429)**	2,102
	Accounts receivable	**3,694**	255
	Alberta royalty tax credit receivable	**230**	625
	Inventories	**(151)**	(92)
		(656)	2,890
	Increase (Decrease) in current liabilities		
	Bank loan	**(400)**	400
	Accounts payable and accrued liabilities	**3,169**	1,978
	Income taxes payable	—	(612)
	Long term debt due within one year	**547**	53
		3,316	1,819
INCREASE (DECREASE) IN WORKING CAPITAL		**(3,972)**	1,071

See accompanying notes.

CANADIAN HOMESTEAD OILS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 1979 AND 1978

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Principles of consolidation

The consolidated financial statements include the accounts of Canadian Homestead Oils Limited and its subsidiary companies all of which are wholly owned.

Accounts of foreign operations are stated in Canadian dollars. Current assets and current liabilities are translated at year-end rates of exchange. Non-current assets and liabilities are translated at rates existing when acquired or incurred. Translation of revenue and expense items, other than depreciation and depletion, was at the average rate for the year. Gains and losses on translation of foreign currencies are included in net earnings.

(b) Full cost method of accounting

The Company follows the full cost method of accounting whereby all costs related to the exploration for and development of oil and gas reserves are initially capitalized. Costs capitalized include land acquisition costs, geological and geophysical expenditures, rentals on undeveloped properties and costs of drilling productive and non-productive wells. Exploration and development costs are allocated to the following cost centres.

(1) North America

(2) North Sea

(3) Others—additional cost centres have been established for each country in which the Company is conducting exploratory activities.

Costs capitalized in the North American cost centre are being depleted on the unit-of-production method based on estimated proven recoverable North American reserves, as determined by independent consultants and Company engineers, except that costs and estimated reserves applicable to Arctic exploration have been excluded in calculating the depletion provision.

Costs capitalized in the North Sea and other centres are being amortized over varying periods. Should exploration in a particular area prove successful, the unamortized balance in that cost centre will be depleted of a unit-of-production basis. Should an area prove to be unproductive, the unamortized balance in that cost centre will be written off to earnings.

(c) Depreciation

Plant and equipment costs are depreciated at 10% on a straight line method over the useful life of the assets with the exception of major gas plants which are depreciated on the unit-of-production method. Other assets are depreciated at rates varying from 6% to 30%.

(d) Maintenance and repairs

Maintenance and repair items are charged to expense as incurred and renewals and betterments are capitalized.

(e) Joint ventures

Substantially all the Company's exploration and production activities related to oil and gas are conducted jointly with others and accordingly the accounts reflect only the Company's proportionate interest in such activities.

2. PROPERTY, PLANT AND EQUIPMENT

	1979			
	Assets at cost	Accumulated Depletion	Accumulated Depreciation	Net
Oil and gas properties	$62,720,000	14,389,000	—	48,331,000
Production and plant equipment	17,241,000	—	4,587,000	12,654,000
Other equipment	303,000	—	148,000	155,000
	$80,264,000	14,389,000	4,735,000	61,140,000

	1978			
	Assets at cost	Accumulated Depletion	Accumulated Depreciation	Net
Oil and gas properties	$49,741,000	12,555,000	—	37,186,000
Production and plant equipment	9,432,000	—	4,067,000	5,365,000
Other equipment	280,000	—	126,000	154,000
	$59,453,000	12,555,000	4,193,000	42,705,000

3. LONG TERM DEBT

	1979	1978
Term bank loan bearing interest at bank prime rate	**$12,000,000**	5,000,000
8¾% Secured note, Series A	—	335,000
8½% Secured note, Series B (payable in U.S. Funds)	—	318,000
	12,000,000	5,653,000
Less amounts due within one year	**1,200,000**	653,000
	$10,800,000	5,000,000

As security for the term bank loan, the Company has agreed to furnish the bank, if requested, with Section 82 security on certain gas properties, and further not to encumber, dispose nor hypothecate any of these properties without the bank's prior consent. The loan is to be repaid from 1980 to 1985 in equal monthly instalments commencing July 1, 1980.

4. SHARE CAPITAL

(a) Changes in the Company's share capital and contributed surplus during the years ended December 31, 1979 and 1978 are as follows:

1979

	Number of shares	Par Value	Contributed Surplus
Common shares December 31, 1978	6,900,180	$690,000	22,683,000
Issued for cash on exercise of employee stock options	89,250	9,000	549,000
Issued to ICG Canadian Propane Ltd. (Note 5)	296,000	30,000	1,944,000
December 31, 1979	7,285,430	$729,000	25,176,000

1978

	Number of shares	Par Value	Contributed Surplus
Common shares December 31, 1977	6,462,680	$646,000	19,516,000
Issued for cash on exercise of employee stock options	42,500	4,000	262,000
Issued under employee stock purchase plan	170,000	17,000	1,428,000
Issued to ICG Canadian Propane Ltd. (Note 5)	225,000	23,000	1,477,000
December 31, 1978	6,900,180	$690,000	22,683,000

(b) Employee stock purchase plan
In 1978, the Company established a Key Employee Stock Purchase Plan under which 200,000 common shares were reserved for purchase and immediate resale by a Trustee to key employees at the average sale price of the Company's shares on the business day last preceding the date of the transaction. During 1978, 170,000 shares were sold to the Trustee and resold to employees under the plan for $8.50 per share. The total purchase price of the shares was advanced interest free by the Company to the Trustee and is included in long term receivables in the accompanying balance sheets. At December 31, 1979 the outstanding receivable from the Trustee was $1,362,000 (1978–$1,445,000), and the number of outstanding shares reserved was 30,000 (1978–30,000).

(c) Employee stock options
At December 31, 1979, no options were outstanding (December 31, 1978–100,500). During 1979, 11,250 option shares were cancelled.

(d) Common shares have been reserved for issue as follows:

	Number of shares	
	1979	1978
Agreement with ICG Canadian Propane Ltd. (Note 5)	**163,838**	459,838
Stock Purchase Plan	**30,000**	30,000
Stock Option Plan	–	100,500
	193,838	590,338

(e) Preferred shares
In 1968 the authorized capital of the Company was increased by the creation of 250,000 Preferred Shares of the par value of $10.00 each, all of which were issued. By December 31, 1976 all of such shares had been converted into Common Shares, purchased for cancellation, or redeemed. The said Preferred Shares are not subject to reissue.

The capital redemption reserve fund arises from redemption of 7,090 of the said Preferred Shares.

5. AGREEMENT

By an agreement between Canadian Homestead Oils Limited ("Homestead") and ICG Canadian Propane Ltd. ("Propane"), Propane expended an aggregate of $9,000,000 in exploration and drilling operations on Homestead's properties, at the rate of $1,500,000 per year, for which it received 1,636,363 common shares of Homestead. The same agreement granted to Propane an option to acquire an additional 1,381,838 common shares by committing to expend an additional amount of $9,212,161 in drilling and exploration operations on Homestead's properties. Propane exercised this option and entered into a second agreement calling for the expenditure in each calendar year of $3,070,720 or such lesser amount, not below $1,500,000, as

Homestead may specify. At December 31, 1979, 1,218,000 shares had been issued under this option. The option expires during 1980. At December 31, 1979 there were 37,000 shares unissued relating to current year's expenditures. All wells drilled and all production obtained belongs to the Company but Propane retains the expenditures for income tax purposes under the agreement.

6. REMUNERATION

The aggregate remuneration of directors and senior officers amounted to $339,000 for the year ended December 31, 1979 (1978–$257,000).

7. INCOME TAXES

The Company follows the tax allocation method of accounting for income taxes whereby deferred taxes are provided to the extent that current taxes have been reduced by claiming capital cost allowances and exploration, development and lease acquisition costs in excess of the related depreciation and depletion provided in the financial statements. Income tax expense has been reduced by investment tax credits of $566,000 in 1979 and $177,000 in 1978.

8. EARNINGS PER SHARE

Earnings per common share is based on the weighted average number of shares outstanding during the year. Fully diluted earnings per common share assumes the issue of reserved shares.

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheets of Canadian Homestead Oils Limited as at December 31, 1979 and 1978 and the consolidated statements of earnings, retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1979 and 1978 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

PEAT MARWICK
MITCHELL & CO.

CHARTERED ACCOUNTANTS

Calgary, Canada
February 18, 1980

INTER-CITY GAS LIMITED *Inter-City Gas Building, 444 St. Mary Avenue, Winnipeg, Manitoba R3C 3T7*